Supreme Court, U.S.
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In The

Supreme Court of the United States

October Term, 1996

THE CITY AND COUNTY OF DENVER, COLORADO,

Petitioner,

v.

BONNIE SONNENFELD, individually and on behalf of all those similarly situated, KARL NICOLETTI, on behalf of himself and all others similarly situated, HILDA EBLING STOLLER TRUST, by Hilda Stoller a/k/a Hilda Stoller Milstein, Trustee, and LARRY RABINOWITZ, on behalf of himself and all others similarly situated,

Respondents.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Tenth Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED FOR REVIEW

Whether the court of appeals erred in concluding that there is an implied private right of action under the Securities Exchange Act of 1934, 15 U.S.C. § 78(a) *et seq.*, against Denver, a municipal issuer of bonds.

STATEMENT REGARDING PARTIES AND CORPORATE AFFILIATES

The caption of this case contains the names of all parties to the appeal to the United States Court of Appeals for the Tenth Circuit, whose judgment is sought to be reviewed. The requirements of Sup. Ct. R. 29.6 regarding disclosure of parent companies and nonwholly owned subsidiaries of corporate filers do not apply to Petitioner, a municipality.

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OPINIONS BELOW

The Tenth Circuit opinion on which review is sought was filed November 12, 1996, and is reported at 100 F.3d 744 (10th Cir. 1996). Appeal to the Tenth Circuit was taken from a district court bench ruling of July 17, 1995, which was followed by an unpublished written order entered August 2, 1995. The Tenth Circuit opinion and the district court's bench ruling and written order are set out at Appendices A, B and C.

SUPREME COURT JURISDICTION

Judgment entered in accordance with the Tenth Circuit opinion (Appendix A) on November 12, 1996. No petition for rehearing was filed, and no extension of time was requested for filing this petition. This Court has jurisdiction to review the Tenth Circuit's opinion and judgment under 28 U.S.C. § 1254(1). The notifications required by Sup. Ct. R. 29.4(b) and (c) do not apply in this case.

PERTINENT STATUTES AND REGULATIONS

The following statutes and regulation relate to the issue raised herein:

**Securities Exchange Act of 1934,
15 U.S.C. § 78c(a)(9) ("Section 3(a)(9)"):**

> The term "person" means a natural person, company, government or political subdivision, agency, or instrumentality of a government.

**Securities Exchange Act of 1934,
15 U.S.C. § 78j(b) ("Section 10b"):**

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange –
>
> * * *
>
> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

**Securities Exchange Act of 1934,
15 U.S.C. § 78o-4(d) ("Tower Amendments"):**

> (d)(1) Neither the Commission nor the Board is authorized under this chapter, by rule or regulation, to require any issuer of municipal securities, directly or indirectly through a purchaser or prospective purchaser of securities from the issuer, to file with the Commission or the Board prior to the sale of such securities by the issuer

any application, report, or document in connection with the issuance, sale, or distribution of such securities.

(2) The Board is not authorized under this chapter to require any issuer of municipal securities, directly or indirectly through a municipal securities broker or municipal securities dealer or otherwise, to furnish to the Board or to a purchaser or a prospective purchaser of such securities any application, report, document, or information with respect to such issuer: *Provided, however,* That the Board may require municipal securities brokers and municipal securities dealers to furnish to the Board or purchasers or prospective purchasers of municipal securities applications, reports, documents, and information with respect to the issuer thereof which is generally available from a source other than such issuer. Nothing in this paragraph shall be construed to impair or limit the power of the Commission under any provision of this Chapter.

Securities Exchange Act of 1934, 15 U.S.C. § 78aa:

The district courts of the United States and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have exclusive jurisdiction of violations of this chapter or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by this chapter or the rules and regulations thereunder. . . .

17 C.F.R. § 240.10b-5 ("Rule 10b-5"):

> Employment of manipulative and deceptive devices.
>
> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
>
> (a) To employ any device, scheme or artifice to defraud,
>
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

STATEMENT OF THE CASE

Introduction and Basis for Federal Jurisdiction

This case arises out of Denver's issuance of bonds to finance the design, construction and certain related costs of Denver International Airport. Four cases (consolidated in the district court) were brought as putative class actions on behalf of bond purchasers. The purchasers (Respondents herein) alleged that Denver and the other defendants – various underwriters and financial advisers – knew of but failed to disclose the existence of extensive

problems that would necessitate delays in opening the airport, and made unrealistic projections of airport revenues and costs. The purchasers further alleged that as a result of these misrepresentations and omissions, they paid artificially high prices for their bonds. Claims were asserted for violations of federal and state securities laws and for common law fraud. Jurisdiction in the district court was based on Section 27 of the Securities Exchange Act of 1934 (15 U.S.C. § 78aa) and 28 U.S.C. § 1331.

Denver moved to dismiss, asserting among other bases for dismissal that the purchasers had no implied private right of action against a municipal issuer of bonds under Section 10b of the 1934 Act (15 U.S.C. § 78j(b)) or Rule 10b-5 promulgated thereunder. After the district court declined to dismiss the complaint on this basis, Denver moved for certification of the securities law issue for interlocutory appeal pursuant to 28 U.S.C. § 1292(b).[1] The district court certified the issue and the Tenth Circuit granted leave to appeal pursuant to Fed. R. App. P. 5 and

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[1] Denver's motion was granted as to the purchasers' state law claims, which were dismissed for failure to comply with the Colorado Governmental Immunity Act, Colo. Rev. Stat. § 24-10-101 *et seq.* Denver also sought and was denied dismissal on the basis that the district court lacked jurisdiction over it under the Eleventh Amendment to the United States Constitution, since construction and operation of the airport was an action undertaken by it as an arm of the state under Colorado law. Denver appealed the district court's Eleventh Amendment ruling under 28 U.S.C. § 1291 as a collateral order. The Tenth Circuit consolidated that appeal with the appeal of the federal securities law issue, and thereafter affirmed the district court's ruling on the Eleventh Amendment issue.

28 U.S.C. § 1292(b). On November 12, 1996, it entered judgment affirming the district court's ruling.

Background Facts

In May 1989, Denver voters approved a referendum to replace Denver's Stapleton Airport with a new airport, to be financed by issuance of airport revenue bonds. Beginning in 1990, airport revenue bonds issued by Denver were sold by and through underwriters in separate offerings to members of the public, including Respondents herein. Various entities provided services to Denver as financial advisers or underwriters in connection with the offerings.

The new Denver International Airport (DIA) was originally scheduled to open on October 31, 1993. However, problems encountered during the construction of the airport, including problems relating to the airport's automated baggage handling system, led to a series of postponements of the opening date. Following an indefinite postponement announced on May 3, 1994, the major rating agencies downgraded the quality ratings of the Denver airport bonds. (After DIA opened and showed positive financial results, the bonds were upgraded to their former status. There has never been a default on the bonds.)

While DIA was under construction, Denver periodically issued official statements and investor reports regarding progress at the airport. The Respondents alleged in their complaint that these official statements and investor reports failed to disclose the serious risk of

delays in the opening date for DIA, and contained "inaccurate and incomplete disclosures" concerning the status of the design and construction of DIA and its baggage system, and concerning the airport's projected revenues and expenses. The Respondents claimed that they had been damaged by the conduct of Denver and the other defendants, because "[i]f the true state of affairs had been disclosed, the Bonds would have been priced much lower than they actually were, and they would have been offered at a much higher rate of interest in order to reflect the significant risks attendant with this huge public works project which the Bonds have financed."

Proceedings in the District Court

In April 1995, Denver filed a motion to dismiss in the district court. It argued that the purchasers' claims against it should be dismissed because there is no implied private right of action against municipal issuers for alleged violations of federal securities laws. Denver pointed out that although this Court has recognized an implied cause of action under Section 10b of the 1934 Act in some circumstances, neither this Court nor any federal circuit court has implied a private right of action against municipal issuers for violations of that section or Rule 10b-5. Moreover, the legislative history of the 1975 amendments to the 1934 Act demonstrates that Congress did not intend that municipal issuers would be liable to private litigants for the type of conduct alleged in the purchasers' complaints.

As Denver explained in its motion, it was generally recognized prior to 1975 that Section 10b afforded no

private right of action against municipalities.[2] In 1975, Congress enacted a number of amendments to the federal securities laws, including the expansion of the definition of "person" in Section 3(a)(9) of the 1934 Act (15 U.S.C. § 78c(a)(9)) to include a "government or political subdivision, agency, or instrumentality of a government." Although some commentators and lower federal courts found that this definitional change meant that, contrary to the prior law, there was now an implied private right of action against municipal issuers, such a conclusion was contrary to the intent of Congress as reflected in the legislative history of the 1975 securities amendments. That legislative history (discussed in detail in Section II of the Argument, below) demonstrates that the amendments were intended to ensure that the professionals trading in the municipal securities market (but *not* the municipalities themselves) would be subject to implied private rights of action under Section 10b.

Although advised of this legislative history, the district court disregarded it and, instead, adopted the reasoning of two federal district courts (*In re Washington Pub. Power Supply System Sec. Litigation*, 623 F. Supp. 1466 (W.D. Wash. 1985), *aff'd*, 823 F.2d 1349 (9th Cir. 1987),[3]

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[2] *See In re N.Y.C. Mun. Sec. Litigation*, 507 F. Supp. 169, 184-86 (S.D.N.Y. 1980), and cases cited therein; *Woods v. Homes & Structures of Pittsburgh, Kan., Inc.*, 489 F. Supp. 1270, 1282 (D. Kan. 1980).

[3] In affirming the district court in *In re Washington Pub. Power Supply System Sec. Litigation*, the Ninth Circuit expressly declined to reach the issue of whether there could be a private right of action against a municipality (823 F.2d at 1358), and in fact cited *In re N.Y.C. Mun. Sec. Litigation* as authority contrary to the district court's resolution of the issue. *Id.* at 1358 n.22.

and *In re CitiSource, Inc. Sec. Litigation*, 694 F. Supp. 1069 (S.D.N.Y. 1988)) which had decided they could resolve the private-right-of-action issue by simply relying on the definition of "person" in Section 3(a)(9), without taking into account the legislative history. The district court agreed with these courts that the "plain language of the statute" – not statutory language affording a private right of action but, instead, the language in Section 3(a)(9) which expanded the definition of "person" to include governmental entities – clearly indicated that there was an implied private right of action against municipalities, and obviated the need for any further analysis.

The Court of Appeals Opinion

Denver appealed to the United States Court of Appeals for the Tenth Circuit, which affirmed the district court's denial of its motion to dismiss. The Tenth Circuit began its analysis by acknowledging that, in determining whether a private cause of action is implicit in a statute not expressly providing one, the central inquiry is whether Congress intended to create a private cause of action. 100 F.3d at 747. It also concluded – notwithstanding the legislative history brought to its attention by Denver – that the legislative history of the 1975 amendments to the 1934 Act "is silent on whether Congress intended municipalities to be subject to a private cause of action under § 10(b)." *Id.* at 748. Nevertheless, it found an implied private right of action by the following reasoning: (1) Congress redefined "person" to include governments and their political subdivisions in 1975, at a time when the federal courts were readily finding private causes of action implicit in statutes and at a time when it

was well established that there was generally an implied private right of action under Section 10b (*id.* at 747); (2) given this "contemporary legal context," when it redefined "person" in 1975 to include municipalities, Congress would have expressly so stated if it intended there to be no private cause of action against municipalities (*id.*); (3) Congress did not expressly so state, and (in the Tenth Circuit's view) the legislative history does not show that Congress intended to exempt municipalities from the private cause of action under Section 10b (*id.*).

Although it acknowledged that subjecting municipalities to civil liability for securities fraud under Section 10b might have grave political and constitutional consequences and could fundamentally alter the relationship between elected officials and the electorate, the Tenth Circuit found that the lack of discussion in the legislative history concerning such a momentous decision was "not necessarily anomalous." *Id.* at 748. The reason was that Congress "may well have intended the 1975 amendment to the definition of person as a clarification of existing law," since there was "some authority" at the time suggesting that municipalities could be subject to the private right of action under Section 10b. *Id.* The court added that even though Congress's interpretation of the pre-1975 statutes might have been incorrect (as evidenced by later decisions holding that Section 10b was inapplicable to municipalities prior to 1975), "the issue is not whether Congress correctly perceived the state of the law, but what its perception of the state of the law was." *Id.* at 749.

Based on this reasoning, the court of appeals concluded that Congress "intended the 1975 amendment [to

the 1934 Act] to recognize an implied private cause of action against municipalities" for violations of Section 10b and Rule 10b-5. *Id.*

ARGUMENT

For the first time, a federal appeals court has held that there is an implied private right of action for damages against municipal issuers for violations of Section 10b and Rule 10b-5. The Tenth Circuit reached this conclusion by (1) altering the inquiry mandated by this Court for deciding whether there is an implied private right of action under a federal statute, and (2) disregarding legislative history that would have required a contrary conclusion even under the test it applied. The result reached by the Tenth Circuit is not only wrong as a matter of law, but raises serious public policy concerns as well. Given the increasing importance of the state and local government securities market, the Tenth Circuit's decision has significance far beyond the parties to this case. This Court should grant certiorari to correct the erroneous analysis and erroneous result of the court of appeals.

I. THE COURT OF APPEALS HAS CHANGED THE TEST FOR DETERMINING WHETHER THERE IS AN IMPLIED PRIVATE RIGHT OF ACTION UNDER A STATUTE.

For nearly two decades, this Court has emphasized that the central inquiry in determining whether a private cause of action is implicit in a statute is whether Congress

intended to create such a cause of action. *See, e.g., Transamerica Mortgage Advisors, Inc. v. Lewis*, 444 U.S. 11, 23 (1979); *Touche Ross & Co v. Redington*, 442 U.S. 560, 575 (1979); *Thompson v. Thompson*, 484 U.S. 174, 189 (1988) (Scalia, J., concurring). The Court has cautioned against expanding the breadth of any implied private right of action beyond the scope intended by Congress (*Virginia Bankshares, Inc. v. Sandberg*, 501 U.S. 1083, 1102 (1991); *cf. Cannon v. Univ. of Chicago*, 441 U.S. 677, 718 (1979) (Rehnquist, J., concurring) ("Not only is it 'far better' for Congress to so specify when it intends private litigants to have a cause of action, but . . . this Court should be extremely reluctant in the future to imply a cause of action absent such specificity on the part of the Legislative Branch"), and has frequently been reluctant to infer private damage remedies under the securities laws. *See, e.g., Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 739 (1975) (noting that "[t]here has been widespread recognition that litigation under Rule 10b-5 presents a danger of vexatiousness different in degree and in kind from that which accompanies litigation in general"); *Touche Ross, supra; Transamerica Mortgage Advisors, supra; Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 114 S. Ct. 1439, 128 L. Ed. 2d 119 (1994).

Although the court of appeals' opinion in this case begins by acknowledging the importance of ascertaining Congress's intent, it thereafter disregards the cautionary dictates of this Court, and instead manages to find an implied private right of action against municipal issuers based on the flimsiest hypothesis of congressional intent. By relying on legislative inaction rather than on any affirmative indication that Congress intended to subject

municipal issuers to private damages actions under the federal securities laws, the Tenth Circuit has turned on its head the test for determining whether there is an implied private right of action under a statute. The test under the court of appeals' opinion is no longer "infer a private right of action only if Congress intended to create one," but "infer a private right of action as long as there is no evidence that Congress did *not* so intend."

In support of its analysis, the Tenth Circuit relies on *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran*, 456 U.S. 353 (1982), in which this Court held that when Congress enacted amendments to the Commodity Exchange Act in 1974, it intended to preserve the existing implied private right of action for damages under the Act. The Tenth Circuit focused on language from *Merrill Lynch* stating that when Congress acts in a statutory context in which an implied private remedy has already been recognized by the courts, the question is not whether Congress intended to create a new remedy but whether Congress intended to preserve the preexisting remedy. 100 F.3d at 747.

Given this Court's caution in finding implied private rights of action under the securities laws, it may be questioned whether the *Merrill Lynch* analysis remains viable in cases involving such an inquiry. However, even if that analysis still applies in appropriate situations, reliance on *Merrill Lynch* was not warranted in this case.

As in *Merrill Lynch*, at the time of the 1975 amendments to the securities laws, there was a recognized private right of action – albeit not against municipalities – for violations of the statute. However, in contrast to *Merrill Lynch* (where the legislative history "persuasively indicate[d] that preservation of the remedy was indeed what Congress actually intended" – 456 U.S. at 382), there was *no* "persuasive legislative history" in this case to support the conclusion that Congress was "preserving a preexisting remedy" when it redefined "person" in 1975 to include governments and political subdivisions. First, contrary to the Tenth Circuit's statement, there had never been any judicial recognition of a private remedy against municipalities.[4] Second and more important: as discussed in Section II below, the legislative history in fact indicates

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[4] The Tenth Circuit could cite only a single district court case in support of its contention that there was "some authority [in 1975] suggesting municipalities could be subject to the well-established private cause of action under § 10(b)" (100 F.3d at 748); and that case (*Baron v. Shields*, 131 F. Supp. 370 (S.D.N.Y. 1954)) does not even directly address the issue. The only mention in *Baron* of the status of the defendant Bridge Commission as a political subdivision of the state is a single sentence regarding whether this status would make the Commission's bonds "exempted securities" ("The fact that the [Commission] may well come within the class of a political subdivision of the state or a public instrumentality of the state and that the bonds would then qualify as exempted securities under section 3 of the Securities Act of 1933, 15 U.S.C. § 77c, is insignificant" – 131 F. Supp. at 372). Whether the purchaser did or did not have a private right of action against the Commission was not discussed. Moreover, as the Tenth Circuit itself recognized, cases decided after 1975 concluded that Section 10b was inapplicable to municipalities under the pre-1975 definition of "person" in the 1934 Act. 100 F.3d at 748.

that Congress did *not* intend that municipalities would henceforth be subject to private civil damages actions.

Although there are thus significant differences between *Merrill Lynch* and the situation presented here, the Tenth Circuit's analysis is subject to the same criticisms as those leveled by the dissenters in *Merrill Lynch*. Justice Powell wrote in his dissent that the Court was invoking a "novel legal theory – one that relies on congressional inaction and erroneous decisions by the lower courts" (*id.* at 398), and explained:

> The decision rests on two theories. First, the Court relies on fewer than a dozen cases in which the lower federal courts *erroneously* upheld private rights of action in the years prior to the 1974 amendments to the CEA. Reasoning that these mistaken decisions constituted "the law" in 1974, the Court holds that Congress must be assumed to have endorsed this path of error when it *failed* to *amend* certain sections of the CEA in that year. This theory is incompatible with our constitutional separation of powers, and in my view it is without support in logic or in law. Additionally – whether alternatively or cumulatively is unclear – the Court finds that Congress in 1974 "affirmatively" manifested its intent to "preserve" private rights of action by adopting particular amendments to the CEA. This finding is reached without even token deference to established tests for discerning congressional intent.

Id. at 395-96. These comments apply equally to the Tenth Circuit's opinion, which likewise relies on congressional inaction and a perception of pre-1975 law that – if it was

indeed the law prior to 1975 – was later held to be erroneous.

The court of appeals' readiness to find an implied private right of action based on congressional silence is even more questionable in light of this Court's 1994 decision in *Central Bank, supra* – a case relied on by both Denver and the Respondents in their appellate briefs, but not mentioned by the Tenth Circuit in its opinion. In *Central Bank,* the respondents argued that, by its silence, Congress must have acquiesced in judicial interpretations of Section 10b as covering aiding and abetting securities fraud. 128 L. Ed. 2d at 138. This Court disagreed, noting the limitations on the "acquiescence doctrine" as an expression of congressional intent, *id.*, and refusing to interpret statutory silence as "tantamount to an implicit congressional intent to impose § 10(b) aiding and abetting liability." *Id.* at 137. (Although he dissented from the majority's decision on the merits, Justice Stevens agreed in his dissent that the Court is "now properly reluctant to recognize private rights of action without an instruction from Congress" – *id.* at 147.)

The Tenth Circuit's analysis has not only led it to the wrong result, but has muddied the inquiry required to determine whether there is an implied private cause of action under a federal statute. As noted above, the specific question of whether there is an implied private right of action under the securities laws against municipal issuers is an issue of significance to local governments and other participants in the municipal securities market; yet as recently as 1995, a leading treatise stated that "the extent of liability of municipal issuers under the federal securities laws is far from settled." Marc I. Steinberg,

Securities Regulation: Liabilities and Remedies (1995), § 13.05, at 13-20. Moreover, this case is of even broader significance because it addresses the more general question of how to decide whether a statute affords an implied private right of action. These are important questions of federal law that "have not been, but should be, settled by this Court." Sup. Ct. R. 10(c).

II. THE COURT OF APPEALS HAS IGNORED LEGISLATIVE HISTORY DEMONSTRATING THAT CONGRESS DID NOT INTEND TO CREATE A PRIVATE RIGHT OF ACTION AGAINST MUNICIPAL ISSUERS.

Even if the analysis employed by the court of appeals were deemed correct, the decision would still warrant review by this Court. The court of appeals reached an erroneous result in a decision that will have a substantial impact not only on Denver but on local governments generally. It did so largely because it failed to consider congressional history evidencing an intent that municipal issuers *not* be subject to private damages actions under the federal securities laws.

It has been observed that using legislative history to interpret statutory language is like "looking over a crowd and picking out your friends."[5] In fact, that is what the Tenth Circuit did in this case. It picked out one statement from the legislative history of the 1975 amendments

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[5] Stephen Breyer, *On the Uses of Legislative History in Interpreting Statutes*, 65 S. Cal. L. Rev. 845, 845-46 (1992), quoting Judge Leventhal.

which it read to support its position, and ignored the rest of that history.

In the Tenth Circuit's view, the Senate Report excerpt which it quotes (100 F.3d at 748) demonstrates that Congress "clearly intended that municipal securities would remain subject to the antifraud provisions" of the securities laws. *Id.* That excerpt can indeed fairly be read to express an intent that municipal securities were to be "subject to the antifraud provisions" in the sense that the SEC would be able to bring enforcement actions against municipal issuers for violations of those provisions. (The Tenth Circuit notes elsewhere in its opinion that under the post-1975 definition of "person," "local governments are subject to actions by the SEC to enforce § 10(b) and Rule 10b-5." *Id.* at 746. The SEC staff did in fact undertake a formal investigation relating to the airport revenue bonds issued by Denver. In October 1996, the SEC staff advised Denver that the inquiry was being terminated and that no enforcement action would be recommended.)

However, the mere fact that the SEC may take action against municipal issuers does *not* mean that private persons have an implied right of action to sue municipal issuers for damages. The inquiries are not the same. *See Cannon*, 441 U.S. at 688 (although the University of Chicago was clearly subject to Title IX, a private right of action analysis was still required to determine whether a woman denied admission to the university's medical school had a private right of action under Title IX against the university); *Virginia Bankshares*, 501 U.S. at 1103-04 ("While it is true that [the House and Senate] Reports . . . carry the clear message that Congress meant to protect investors from misinformation . . . it is just as true

that Congress was reticent with indications of how far this protection might depend on self-help by private action").

Not only does the Senate Report cited by the court of appeals say nothing whatever about private rights of action, but other legislative history from 1975 (relevant portions of which are set out at Appendix D hereto) indicates that Congress did not intend to subject municipal issuers to private damages liability under Section 10b. As this legislative history demonstrates, the 1975 amendments (including the redefinition of "person" to include governments and political subdivisions) were prompted by congressional concern over abuses committed by professionals (brokers, dealers, and bankers) engaged in the municipal securities business – and not by any concern over abuses by municipal issuers. *See Finkielstain v. Seidel*, 692 F. Supp. 1497, 1505 (S.D.N.Y.) (addressing issue of immunity of states under Section 10b), *aff'd in part and rev'd in part*, 857 F.2d 893 (2d Cir. 1988):

> The Securities Acts Amendments of 1975 were provoked by congressional desire to subject the "brokers and dealers and banks engaged in a municipal securities business" to federal regulation. S. Rep. No. 94-75, 94th Cong., 1st Sess. 3, *reprinted in* 1975 U.S. Code Cong. & Admin. News, 179, 182. . . . In light of a reported increase in the amount of fraud in the municipal securities trading industry, Congress intended to subject broker-dealers to liability for "unconscionable markups, churning of customers' accounts, misrepresentations concerning the nature and value of municipal securities, disregard of suitability standards, and scandalous

high-pressure sales techniques." *Id.* at 43, 1975 U.S. Code Cong. & Admin. News at 221.

Accord, CitiSource, 694 F. Supp. at 1074 ("[T]he Senate's principal interest in the municipal securities market lay not with municipal issuers, but with the professionals trading in that market – the brokers, dealers and bankers. . . . The Senate's bill reflected the concern of that body that abuses committed by a limited number of these professionals had undermined the public's confidence in a municipal securities market and thereby threatened municipalities' access to capital").

In enacting amendments that would regulate municipal securities market professionals, Congress took pains to make explicit that it did not intend by those amendments to impose new types of liability on municipalities *as issuers*. *CitiSource*, 694 F. Supp. at 1074 n.8; *In re N.Y.C. Mun. Sec. Litigation*, 507 F. Supp. at 182 ("although Congress sought to establish a regulatory scheme for the municipal securities *market* by the adoption of the 1975 amendments, what Commissioner Landis referred to as 'obvious political reasons' again led Congress to regulate municipal securities dealers but to exempt the municipalities themselves").

In a section of its report entitled REGULATION OF MUNICIPAL SECURITIES PROFESSIONALS – NOT ISSUERS (S. Rep. No. 94-75, at 44 (1975), *reprinted in* 1975 U.S.C.C.A.N. 179, 221) (*see* Appendix D), the Senate cited concerns raised by municipal issuers about possible "collateral effects" on them of the 1975 amendments. In an attempt to address such concerns and ensure that the amendments would not be interpreted as subjecting

municipal issuers to liability where they had not been liable before, Congress simultaneously passed the Tower Amendments (codified at 15 U.S.C. § 78o-4(d)), which exempted issuers of municipal securities from the registration and reporting requirements imposed on underwriters, dealers and brokers. In the words of one of the bill's sponsors, the aim of the Tower Amendments was to ensure that the 1934 Act (as amended) would not "tamper in any way with prerogatives of state and local governments in their sales of securities." Remarks of Sen. Williams (at 121 Cong. Rec. 6188 (1975)), cited in *N.Y.C. Mun. Sec. Litigation*, 507 F. Supp. at 183; *see also Woods*, 489 F. Supp. at 128.

Thus even after the definition of "person" in Section 3(a)(9) was expanded in 1975, Congress sought to ensure that the amendments would not be read to create a private right of action against municipalities as issuers. After reviewing in detail the legislative history of the 1975 amendments, one commentator has concluded:

> Congress' attempt to purge the 1975 amendments of even indirect regulatory effects on local governments is incompatible with an intent to subject these governments to the daunting prospect of private litigation under section 10(b) and rule 10b-5. It strains credulity to suppose that Congress would precipitate a change of this nature without comment while simultaneously insisting that the legislation did not affect local governments even indirectly.

Margaret V. Sachs, *Are Local Governments Liable Under Rule 10b-5? Textualism and Its Limits*, 70 Wash. U.L.Q. 19, 47 (1992).

In sum, although the provision cited by the Tenth Circuit may reflect an intent that municipal securities were to be subject to the antifraud provisions of the securities laws, it does not by any means reflect an intent to subject municipalities to *private rights of action* for violation of those provisions. If anything is to be gleaned from the legislative history of the 1975 amendments, it is that that was *not* the intent of Congress.

The Tenth Circuit should not have ignored this legislative history. Although reliance on legislative history has been criticized,[6] legislative history cannot be disregarded – or invoked only selectively – in a case such as this. The question presented here implicates two lines of cases – federal securities cases, and cases involving the liability of local governments under federal statutes – in which this Court has accorded significant weight to legislative history, even in the face of seemingly clear statutory language. *See Sachs*, 70 Wash. U.L.Q. at 26-33, and cases cited there; *see also Blue Chip Stamps*, 421 U.S. at 737 (noting that "we would by no means be understood as suggesting that we are able to divine from the language of § 10(b) the express 'intent of Congress' as to the contours of a private cause of action under Rule 10b-5"); *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 212 (1976) (although language of Rule 10b-5, viewed in isolation, could be read as the SEC urged, such a reading could not "be harmonized with the administrative history of the Rule"); *Santa Fe Industries, Inc. v. Green*, 430 U.S. 462, 473

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[6] *See Breyer*, 65 S. Cal. L.R. at 845-45; *but see id.* at 869: "As with old age, what exactly is the alternative to legislative history?"

(1977) (noting that Court had not been "cited to any evidence in the legislative history that would support a departure from the language of the statute").

Denver believes that the legislative history discussed above compels the conclusion that there is no implied private right of action against municipal issuers for violations of Section 10b and Rule 10b-5, regardless of whether the Tenth Circuit's analysis was otherwise correct. At a minimum, the court of appeals' treatment of the legislative history in this case suggests a need for guidance from this Court as to how legislative history may be used to divine congressional intent.

III. INFERRING A PRIVATE RIGHT OF ACTION AGAINST MUNICIPAL ISSUERS IS UNNECESSARY FOR THE PROTECTION OF INVESTORS AND IS CONTRARY TO PUBLIC POLICY.

The court of appeals' decision is bad policy as well as bad law. As discussed above, this Court has been reluctant to find implied private rights of action absent compelling evidence – lacking in this case – that Congress intended such a cause of action. (Indeed, Justice Scalia suggested almost a decade ago that it might be time for the Court to "get out of the business of implied private rights of action altogether." *Thompson*, 484 U.S. at 192 (Scalia, J. concurring).) One situation in which the Court has been particularly hesitant to infer a private right of action is where there is already a remedy available for violations of a statute. For example, in *Transamerica Mortgage Advisors, supra*, this Court found that the existence of

a public means of enforcing the duties imposed by Section 206 of the Investment Advisers Act of 1940 (15 U.S.C. § 80b-6) supported the conclusion that there was no private right of action for damages under that section. 444 U.S. at 19-20. Similarly, where municipalities are subject to SEC enforcement actions, it is unnecessary to infer a private right of action in order to protect municipal securities investors. As one authority points out: "[T]he SEC has sought and has been granted ancillary relief in the form of restitution for municipal securities investors. Thus, SEC action can ensure that if Congress' purpose is the protection of municipal securities investors, this purpose will be fulfilled." Thomas J. Schwarz, *Municipal Bonds and the Securities Laws: Do Investors Have an Implied Private Remedy?*, 7 Sec. Reg. L.J. 119, 154 (1979).[7]

Not only is an implied private right of action an unnecessary remedy, but it may in fact impede rather than advance the purposes of the antifraud provisions. As noted by the dissenters in *Merrill Lynch*:

> [M]odern federal regulatory statutes tend to be exceedingly complex. Especially in this context, courts should recognize that intricate policy calculations are necessary to decide when new enforcement measures are desirable additions to a particular regulatory structure. Judicial creation of private rights of action is as likely to

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[7] Further, as the Tenth Circuit noted, it is "well established that underwriters, brokers, and dealers in municipal securities may be liable in a private cause of action." 100 F.3d at 746 n.1. Such a result not only accords with Congress's concerns in 1975, discussed above, but also provides an additional layer of protection for investors in municipal securities.

> disrupt as to assist the functioning of the regulatory schemes developed by Congress.

456 U.S. at 408. In *Central Bank*, this Court observed: "Extending the 10b-5 cause of action to aiders and abettors no doubt makes the civil remedy more far-reaching, but it does not follow that the objectives of the statute are better served. Secondary liability for aiders and abettors exacts costs that may disserve the goals of fair dealing and efficiency in the securities markets." 129 L. Ed. 2d at 139. Other observers have similarly noted that the implication of private rights of action can actually impede rather than advance the fundamental purpose of the securities laws, and that statutory policy sometimes militates against private remedies. *See* Tamar Frankel, *Implied Rights of Action*, 67 Va. L. Rev. 553, 568, 582 (1981); Dennis Scholl and Ronald K. Perkowski, *An Implied Right of Action Under Section 17(a): The Supreme Court Has Said "No," But Is Anybody Listening?*, 36 U. Miami L. Rev. 41, 61-64 (1982); Schwarz, *supra*, 7 Sec. Reg. L.J. at 154.

In addition to being unnecessary and potentially disruptive to the overall regulatory scheme under the securities laws, implication of a private right of action against municipal issuers will have serious adverse effects on the ability of municipalities to use bonds to fund their capital needs. The municipal securities market is growing rapidly, as municipalities, faced with declining revenues from other sources, look to bonds to fund major public projects such as Denver International Airport.[8] One commentator has noted that it is hardly surprising that the

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[8] The Board of Governors of the Federal Reserve System estimated the total value of the tax-exempt securities market as of December 31, 1994, at $1,203 trillion. U.S. Bureau of the

issue of whether local governments can be sued for damages for violation of the securities laws has arisen in the 1990s:

> Faced with cuts in federal aid, state and local governments issued twice the volume of securities in 1990 as in 1980. Fraud litigation involving these securities has been brought against not only brokers, dealers, and other private actors, but also the governments themselves. Such litigation against governments is bound to swell. . . . In addition, many local government issuers are widely thought to be on the verge of default, a fact undoubtedly conducive to Rule 10b-5 actions.

Sachs, 70 Wash. U.L.Q. at 20-21.

Local governments may have to decide against issuing bonds if doing so will subject them and their citizenry to the "particularly vexatious" private litigation that can now be brought against them under the Tenth Circuit's opinion. As this Court observed in *Central Bank*, litigation under Rule 10b-5 requires defendants to expend large sums even for pretrial defense and the negotiation of settlements. 128 L. Ed. 2d at 140. Further, such suits are often settled even where the claims have little if any merit – primarily because the defendants are exposed to the risk of damage awards that may be sizable but are

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Census, *Statistical Abstract of the U.S.: 1995* (115th ed. 1995), No. 825.

difficult to measure in advance.[9] Frankel, 67 Va. L. Rev. at 574-75. A local government, which needs predictability in financial matters, may find itself with little choice but to settle even a meritless suit rather than undergo the disruption and expense of defending.

Before subjecting local governments and their citizens to the financial hardship that may flow from opening the doors to private damage actions for violations of the securities laws, the courts should assure themselves that Congress clearly favored such a result. *See City of Newport v. Fact Concerts, Inc.*, 453 U.S. 247, 267, 270 (1981). The Tenth Circuit failed to do that in this case.

Finally, the court of appeals' holding implicates the concerns about comity and federalism that were in the mind of Congress when it sought to ensure that the 1975 securities laws amendments would not be interpreted in such a way as to interfere with the day-to-day conduct of local government. As one court has explained:

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[9] As this Court noted in *Blue Chip Stamps*, 421 U.S. at 740:

> [I]n the field of federal securities laws governing disclosure of information, even a complaint which by objective standards may have very little chance of success at trial has a settlement value to the plaintiff out of any proportion to its prospect of success at trial so long as he may prevent the suit from being resolved against him by dismissal or summary judgment. The very pendency of the lawsuit may frustrate or delay normal business activity of the defendant which is totally unrelated to the lawsuit.

> Congress apparently felt that grave political and constitutional consequences flowed from subjecting the day-to-day conduct of municipal officials to the scrutiny of the federal securities laws. For example, exposing the mayor of a city to strict anti-fraud liability under § 10(b) for otherwise general remarks made during an after-dinner speech to constituents would be highly questionable, and would fundamentally alter the relationship between elected officials and the electorate. In my opinion, interjection of the federal securities laws into clearly political affairs of local government would represent an unwarranted intrusion into the political life of the community.

In re N.Y.C. Mun. Sec. Litigation, 507 F. Supp. at 185-86.

This Court has long warned against unnecessary encroachment by the federal government and the federal courts on state and local governments in the course of safeguarding federal interests. *See Younger v. Harris*, 401 U.S. 37, 44 (1971); *City of Columbia v. Omni Outdoor Advertising, Inc.*, 499 U.S. 365, 370 (1991). Issuance of municipal bonds is in many respects peculiarly a matter of local concern. Schwarz explains:

> The power of a municipality to issue debt securities is not an inherent one; the state constitution or the state legislature must expressly empower a municipality to contract for such debt. The constitutional provision, statute, or charter that creates the authority of a municipality to issue debt securities also provides limitations on various aspects of the issues. When a municipality fails to pay its debt obligations as they mature, the holder of municipal bonds may sue for payment. A municipal securities holder

> may bring a suit based on a fraudulently induced transaction. In addition to this common-law fraud action, most states provide express civil remedies for defrauded municipal securities investors in their Blue Sky legislation.

7 Sec. Reg. L.J. at 155-56. As Schwarz points out, there are already numerous remedies available to municipal securities investors under state law. (In this case, for example, the Respondents brought a claim under the Colorado Securities Act, Colo. Rev. Stat. §§ 11-51-501 and 11-51-604.) In such circumstances, creation of an additional federal remedy by inferring a private right of action against municipal issuers under the federal securities laws is an unnecessary encroachment on local governments and an unwarranted intrusion into an area that is largely a matter of state and local concern.

IV. CONCLUSION

Prior to the Tenth Circuit's decision, no federal court of appeals had considered whether there was an implied private right of action against municipal issuers under Section 10b and Rule 10b-5. The Tenth Circuit has attempted to resolve this issue, but its resolution is wrong, both in analysis and in result, for the reasons outlined above.

As noted above, the issue is of importance far beyond Denver's case, given the size of the municipal securities market and the consequences to municipal issuers if they are exposed to private damages suits. This Court should therefore grant certiorari and address the question raised herein, not only to correct the analysis and result reached

by the court of appeals, but also to clarify when private rights of action will be inferred and what is required to ascertain congressional intent when a statute is silent.

Respectfully submitted,

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APPENDIX A

PUBLISH

UNITED STATES COURT OF APPEALS

TENTH CIRCUIT

BONNIE SONNENFELD, individually and on behalf of all those similarly situated; KARL NICOLETTI, on behalf of himself and all others similarly situated; HILDA EBLING STOLLER TRUST, by Hilda Stoller, also known as Hilda Stoller Milstein; LARRY RABINOWITZ, on behalf of himself and all others similarly situated,

Plaintiffs-Appellees,

v.

DENVER, CITY and COUNTY OF,

Defendant-Appellant,

and

LAZARD FRERES; PRYOR, MCCLENDON, COUNTS & COMPANY; GOLDMAN, SACHS & COMPANY; LS FINANCIAL INC.; DAIN BOSWORTH, INC.; LEHMAN BROTHERS, INC.; ARTEMIS CAPITAL GROUP, INC.; PIPER JAFFRAY, INC.,

Defendants.

No. 95-1357
No. 95-1431
(Consolidated)

(Filed
Nov. 12, 1996)

Appeal from United States District Court
for the District of Colorado
(D.C. Nos. 95-Z-468, 95-Z-492, 95-Z-548, 95-Z-728)

James M. Lyons (Frederick J. Baumann and JoAnn L. Vogt with him on the brief), of Rothgerber, Appel, Powers & Johnson, Denver, Colorado, for the appellant.

Sherrie R. Savett, of Berger & Montague, P.C., Philadelphia, Pennsylvania (Genna Driscoll Kidd, of Berger & Montague, P.C., Philadelphia, Pennsylvania; and Kevin J. Yourman of Weiss & Yourman, Los Angeles, California, with her on the brief), for the appellees.

Before HENRY, LOGAN, and BRISCOE, Circuit Judges.

BRISCOE, Circuit Judge.

Plaintiffs brought these four consolidated class actions alleging the City and County of Denver made false and misleading statements, in violation of § 10(b) of the Securities Exchange Act of 1934 (15 U.S.C. § 78j(b)) and Securities Exchange Commission Rule 10b-5, in the issuance of bonds to finance a new airport. Denver moved to dismiss, arguing there is no implied private right of action against municipalities under § 10(b) or Rule 10(b)-5 and that it was immune under the Eleventh

Amendment. Denver appeals the district court's denial of its motion. We have jurisdiction over the securities law issue under 28 U.S.C. § 1292(b). The Eleventh Amendment issue is appealable under the collateral order doctrine. *See Puerto Rico Aqueduct and Sewer Authority v. Metcalf & Eddy*, 506 U.S. 139 (1993). We affirm.

Implied Private Cause of Action

Denver contends there is no implied private cause of action against municipalities under § 10b and Rule 10b-5. We disagree.

Section 10(b) makes it unlawful for "any person" to use or employ any manipulative or deceptive device or contrivance in connection with the purchase or sale of any security. Section 3(a)(9) (15 U.S.C. § 78c(a)(9)) defines person to include a "government, or political subdivision, agency, or instrumentality of a government." Under this definition, local governments are subject to actions by the SEC to enforce § 10(b) and Rule 10b-5. *See In re County of Orange*, 61 S.E.C. 310, 1996 WL 34362 (1996).[1]

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[1] Although under § 3(a)(12) (15 U.S.C. § 78c(a)(12)) municipal securities are "exempted securities," § 10(b) applies to fraud in connection with the purchase or sale of "any security," and is not limited to nonexempt securities. Section 10(b) therefore applies to transactions in municipal securities, and it is well-established that underwriters, brokers, and dealers in municipal securities may be liable in a private cause of action. *See In re New York City Municipal Securities Litigation*, 507 F. Supp. 169, 178-80 (S.D. N.Y. 1980); *Davidson v. Dean Witter Reynolds*, 478 F. Supp. 494, 495 (D. Colo. 1979).

Although § 10(b) does not provide an express private cause of action, the existence of an implied private cause of action under § 10(b) and Rule 10b-5 is so well established in the courts that its existence is "beyond peradventure." *Herman & MacLean v. Huddleston,* 459 U.S. 375, 380 (1983). *See Ernst & Ernst v. Hochfelder,* 425 U.S. 185, 196 (1976). The implied private cause of action was first recognized in 1946 in *Kardon v. National Gypsum Co.,* 69 F. Supp. 512 (E.D. Pa. 1946), and by 1971, in *Superintendent of Ins. v. Bankers Life & Cas. Co.,* 404 U.S. 6, 13, n. 9 (1971), the Supreme Court "confirmed wit virtually no discussion the overwhelming consensus of the District Courts and Courts of Appeals that such a cause of action did exist." *Blue Chip Stamps v. Manor Drug Stores,* 421 U.S. 723, 730 (1975).

However, it was not until 1975 that Congress added governments and political subdivisions to the definition of person in § 3(a)(9) of the 1934 Act, *see* Pub. L. 94-29, § 3, 89 Stat. 97 (1975), thereby clearly making it unlawful under § 10(b) for issuers of municipal bonds to use or employ any manipulative or deceptive device or contrivance in connection with the purchase or sale of any security. Denver argues Congress did not intend to create an implied private § 10(b) cause of action against municipalities when it expressly subjected governments and political subdivisions to § 10(b).

Here, the district court followed *In re Citysource Securities Litigation,* 694 F. Supp. 1069, 1072-75 (S.D. N.Y. 1988), and *In re Washington Public Power Supply System Securities Litigation,* 623 F. Supp. 1466, 1477-80 (W.D. Wash. 1985), *aff'd on other grounds* 823 F.2d 1349 (9th Cir. 1987), holding that by expressly including governments

and political subdivisions in the definition of person, Congress subjected municipalities to § 10(b) and the well-established private cause of action under that section. Most commentators have concluded the 1975 amendment subjects municipalities to a private cause of action under § 10(b). *See, e.g.*, Robert W. Doty & John E. Peterson, *The Federal Securities Laws and Transactions in Municipal Securities*, 71 Nw. U. L. Rev. 283, 286, 294 (1976); Ann J. Gellis, *Mandatory Disclosure for Municipal Securities: Issues in Implementation*, 13 J. Corp. L. 65, 67 (1987); Joel Seligman, *The Municipal Disclosure Debate*, 9 Del. J. Corp. L. 647, 650-51 n. 14 (1984); Marc I. Steinberg, *Municipal Issuer Liability Under the Federal Securities Laws*, 6 J. Corp. L. 277, 279-80 (1980). *But see* Margaret V. Sachs, *Are Local Governments Liable Under Rule 10b-5? Textualism and its Limits*, 70 Wash. U. L. Q. 19 (1992); Thomas J. Schwarz, *Municipal Bonds and the Securities Laws: Do Investors Have an Implied Private Remedy?*, 7 Sec. Reg. L. J. 119 (1979).

We agree with the district court, *Citysource*, and *Washington Public Power*. In determining whether a private cause of action is implicit in a statute not expressly providing one, the central inquiry is whether Congress intended to create a private cause of action. *Transamerica Mortgage Advisors v. Lewis*, 444 U.S. 11, 23 (1979); *Touche Ross & Co. v. Redington*, 442 U.S. 560, 575 (1979). Denver's reliance on *Cort v. Ash*, 422 U.S. 66 (1975), is misplaced. *Cort*'s four factors have been effectively condensed into one – whether Congress, expressly or by implication, intended to create a private cause of action. *Transamerica*, 444 U.S. at 15-16; *Touche Ross*, 442 U.S. at 575. *See Thompson v. Thompson*, 484 U.S. 174, 189 (1988) (Scalia, J.,

concurring); *Schmeling v. Nordham*, 97 F.3d 1336, 1996 WL 564403 *8-9 (10th Cir. 1996).

In determining whether a private cause of action is implicit in a federal statutory scheme when the statute by its terms is silent on that issue, the initial focus must be on the state of the law at the time the legislation was enacted – the "contemporary legal context" existent when the new law was enacted. *See Merrill Lynch, Pierce, Fenner & Smith v. Curran*, 456 U.S. 353, 378. When Congress acts in a statutory context in which an implied private remedy has already been recognized by the courts, the inquiry is logically different. Congress need not have intended to create a new remedy since one already existed. The question is whether Congress intended to preserve or, in this case, to extend the preexisting remedy. *Id.* at 378-79. Congress is presumed to be aware of prior judicial recognition of an implied private cause of action in a statute that does not expressly provide one. *Id.* at 379.

In 1975 when Congress enacted the amendment that defined person to include governments and their political subdivisions and thereby expressly brought municipalities within the scope of § 10(b), it was well established there was a private right of action under § 10(b). Moreover, until the Supreme Court decided *Cort*, 422 U.S. 66, on June 17, 1975, shortly after the 1975 amendment took effect on June 4, 1975, the federal courts, including the Supreme Court, readily found private causes of action implicit in statutes that did not expressly provide them, following the maxim that where there is a right, there is a remedy. *See, e.g., J.I. Case Co. v. Borak*, 377 U.S. 426 (1964). *Cort* marked the beginning of a more restrictive approach to implied private causes of action. *See, e.g.*, Tamar

Frankel, *Implied Rights of Action*, 67 Va. L.Rev. 553 (1981); Dennis Scholl and Ronald K. Perkowski, *An Implied Right of Action Under Section 17(a): The Supreme Court Has Said "No," But Is Anybody Listening?*, 36 U. Miami L. Rev. 41, 57-65 (1981); Note, *Howard v. Pierce: Implied Causes of Action and the Ongoing Vitality of Cort v. Ash*, 80 Nw. U. L. Rev. 722, 766, n. 7 (1985).

We conclude that in the contemporary legal context of 1975, Congress intended by its 1975 amendment to subject municipalities to the then well-established private right of action under § 10(b) when it expressly brought municipalities within the scope of that section. Given the contemporary legal context of the amendment's passage, had Congress intended there to be no private cause of action against municipalities, it expressly would have stated such an exemption.

The limited legislative history on this issue does not show that Congress intended to exempt municipalities from the private cause of action under § 10(b). The Senate report to the 1975 amendments stated:

> B. Regulation of Municipal Securities Professionals-Not Issuers
>
> The Committee is mindful of the historical relationship between the federal securities laws and issuers of municipal securities. *Apart from the general antifraud provision, municipal securities are exempt from all substantive requirements.* Most significantly, this means that state and local governments do not have to comply with the registration and disclosure requirements of the Securities Act of 1933. The bill does not in any way change this pattern, for the Committee is

> not aware of any abuses which would justify such a radical incursion on states' prerogatives.

S. Rep. No. 75, 94th Cong., 1st Sess., 1975 WL 12347 (Leg. Hist.) *95 (1975). (Emphasis added.) The principal concern of Congress in enacting the 1975 amendments to the securities laws was to regulate underwriters, dealers, and brokers who deal in municipal bonds. *See* S. Rep. No. 75. Congress clearly intended that municipalities would not be subject to the registration and reporting requirements imposed on underwriters, dealers, and brokers. 15 U.S.C. §§ 78c(d) and 780-4(d). However, Congress also clearly intended that municipal securities would remain subject to the antifraud provisions. S. Rep. No. 75, 1975 WL 12347 *91-92, 95.

The legislative history is silent on whether Congress intended municipalities to be subject to a private cause of action under § 10(b). Although subjecting municipalities to civil liability for securities fraud under § 10(b) may have "grave political and constitutional consequences" and could "fundamentally alter the relationship between elected officials and the electorate," *see In re New York Municipal Securities Litigation,* 507 F. Supp. 169, 185-86 (S.D. N.Y. 1980), the lack of discussion in the legislative history is not necessarily anomalous because Congress may well have intended the 1975 amendment to the definition of person as a clarification of existing law.

It was not yet established in 1975 that the phrase "any person" in § 10(b) did not include issuers of municipal securities. Although under the applicable version of § 3(a)(9) of the 1934 Act (15 U.S.C. § 78c(9)), "person" did not include governments and political subdivisions, it did

include corporations, which arguably could include municipal corporations. *See Brown v. City of Covington*, 805 F.2d 1266, 1271-75 (6th Cir. 1986) (Merritt, J., dissenting). The SEC has taken the position that issuers of municipal securities have been included in the definition of person since 1934, and were therefore subject to liability under § 10(b) and Rule 10b-5. *See id.* at 1273-74; *New York City*, 507 F. Supp. at 183, n. 33; Securities Exchange Act Release No. 11,876, [1975-76 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 80,333, at 85,826-34 (Nov. 26, 1975).

It is true that courts that have considered the issue of whether a municipality is a person within the pre-1975 definition in the 1934 Act have concluded § 10(b) was inapplicable to municipalities. *Brown*, 805 F.2d at 1268-70; *In re New York City*, 507 F. Supp. at 181-82; *Woods v. Homes and Structures of Pittsburg*, 489 F. Supp. 1270 (D. Kan. 1980); *In re Equity Funding Corp.*, 416 F. Supp. 161 (C.D. Cal. 1976); *Greenspan v. Crosbie*, 1976 WL 841, Fed. Sec. L. Rep. (CCH) ¶ 95,780 (S.D. N.Y. 1976). They reason that if Congress had intended to include governments and political subdivisions in the definition of person, it could have done so expressly as it did in § 2(2) of the 1933 Act (15 U.S.C. § 77b(2)).

However, these cases had not yet been decided when Congress passed the 1975 amendment and there was some authority suggesting municipalities could be subject to the well-established private cause of action under § 10(b). In *Baron v. Shields*, 131 F. Supp. 370 (S.D. N.Y. 1954), the purchaser of bonds issued by the Bridge Commission of Bellevue, Nebraska, sued the commission, its members, the members of the securities firm that sold the bonds, and the salesman for fraud under § 10(b) and Rule

10b-5. In denying the commission's motion to dismiss, the court stated it was "insignificant" that the commission was a political subdivision or agency of a state and that the bonds would be exempted securities under § 3 of the Securities Act of 1933, 15 U.S.C. § 77c, because § 10(b) of the 1934 Act applies to sales of "any security." However, the court did not address whether the commission was a person within the meaning of the 1934 Act.

In the contemporary legal context of 1975, Congress may well have considered the change in the definition of person a clarification of existing law rather than a change. Although that interpretation of the pre-1975 statutes may be incorrect, *see, e.g., Brown,* 805 F.2d at 1268-70, the issue is not whether Congress correctly perceived the state of the law, but what its perception of the state of the law was. *See Merrill Lynch,* 456 U.S. at 378 n. 61.

We conclude Congress intended the 1975 amendment to recognize an implied private cause of action against municipalities.

Eleventh Amendment Immunity

Denver contends it is an arm of the state entitled to Eleventh Amendment immunity. We disagree.

Whether a governmental entity is entitled to Eleventh Amendment immunity turns on the characterization of the entity under state law, the guidance and control exercised by the state, the degree of state funding, and the entity's ability to provide for its own financing by levying taxes and issuing bonds. *See, e.g., Halderman v. Wyoming Farm Loan Bd.,* 32 F.3d 469, 473 (10th Cir. 1994); *Ambus v.*

Granite Bd. of Educ., 995 F.2d 992, 994-97 (10th Cir. 1993). *See Mt. Healthy City School Dist. Bd. of Educ. v. Doyle*, 429 U.S. 274, 279-80 (1977). The most important factor in determining whether a governmental entity is entitled to Eleventh Amendment immunity is whether a judgment against it would be paid from the state treasury. *Hess v. Port Authority Trans-Hudson Corp.*, 115 S.Ct. 394, 404 (1994). Cities and counties are not entitled to Eleventh Amendment immunity. *Hess*, 115 S.Ct. at 404; *Mt. Healthy*, 429 U.S. at 280; *Mascheroni v. Board of Regents*, 28 F.3d 1554, 1559 (10th Cir. 1994). *Cf. Jordano v. Steffen*, 787 F. Supp. 886, 893, n. 11 (D. Minn. 1992) (holding although counties are not normally immune under Eleventh Amendment, defendant county was immune because it acted as agent of state in administering state Medicaid plan and any judgment would be paid by the state); *Oyler v. City and County of Denver*, 1990 WL 134485 (D. Colo. 1990) (county department of social services immune because it acted as agent of state in administering state welfare programs and received 80 percent of its funding from the state).

However, relying on *Pueblo Aircraft Service v. City of Pueblo*, 679 F.2d 805 (10th Cir. 1982), *cert. denied*, 459 U.S. 1126 (1983), Denver contends it is carrying out a state purpose in building an airport and is therefore an arm of the state entitled to Eleventh Amendment immunity. Denver's reliance on *Pueblo Aircraft Service* is misplaced. That case addressed a city's immunity from the antitrust laws, an entirely different issue.

Although Denver may be carrying out state policy in building an airport, *see* Colo. Rev. Stat. Ann. § 41-4-101 (West 1990); *Pueblo Aircraft Service*, 679 F.2d at 810-11,

under the factors set out in *Mt. Healthy* and *Ambus*, it did not thereby become the alter ego, arm, or instrumentality of the state for purposes of the Eleventh Amendment. As a constitutionally created home rule city, Denver has a great deal of autonomy in local affairs. *City and County of Denver v. Colorado*, 788 P.2d 764 (Colo. 1990); *Fraternal Order of Police v. City and County of Denver*, 914 P.2d 483 (Colo. App. 1995), *cert. granted* (Colo. March 25, 1996). *See* Colo. Const. art. 20, § 1; Colo. Rev. Stat. §§ 30-35-101 through 30-35-202; §§ 31-2-201-31-1-202, 31-15-101 through 31-15-302 (West 1990 and Supp. 1996). Denver has not shown the degree of state funding it receives, either generally or for the airport. Denver has the power to levy taxes and issue bonds. Colo. Rev. Stat. §§ 30-20-301 through 30-20-309; 30-35-201(5) and (6); 31-15-302(1)(c) and (d); 41-4-105, 41-4-203, 41-5-101 (West 1990 and Supp. 1996). Most important, Denver has not shown that a judgment against it would be paid out of the state treasury. The airport bonds are special obligations of the City that in no event "constitute a general obligation of the City, the State or any political subdivision or agency of the State." (Appellant's append. 207.) We conclude Denver is not an arm of the state entitled to Eleventh Amendment immunity.

The judgment of the district court is AFFIRMED.

APPENDIX B

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO

Civil Action No. 95-Z-468

BONNIE SONNENFELD,

Plaintiff,

vs.

THE CITY AND COUNTY OF DENVER, COLORADO,

Defendant.

REPORTER'S TRANSCRIPT
(Hearing on Motion to Dismiss)

Proceedings before the HONORABLE ZITA L. WEINSHIENK, Judge, United States District Court for the District of Colorado, commencing at 8:45 a.m., on the 17th day of July, 1995, in courtroom C-400, United States Courthouse, Denver, Colorado.

* * *

[p. 26] RULING

THE COURT: On the first issue, Mr. Lyons makes a very fervent and complex argument concerning the effect to be given to the 1975 amendment; but I think clear language is clear language. And from the plain language of the statute, which is that the term person means not only a natural person but also a government or political subdivision, this court is of the opinion that I

should not look beyond the clear plain language of the statute.

I agree with the reasoning of the court in **In re Washington Public Power,** which reasoned that it would be hard to accept that Congress did not want municipalities to be truthful in issuing their bonds.

I don't think we have to comply indicate it anymore than to say there clearly was a private right of action, Congress extended this to municipalities, and there still may be a private right of action after '75 against the municipalities.

So I agree with the reasoning in the **Washington Public Power** case, **In re Citisource.** There hasn't been a circuit case. Perhaps there will be.

As far as the Eleventh Amendment is concerned, the test is to determine if a municipality is acting as an arm of the state to determine if it is the real party in interest; and the question is whether a judgment is going to be paid out of [p. 27] the state treasury.

Port Arthur is – has been cited, is 495 U.S. 13. I think that's the right cite. We'll double-check it.

In any case, I have no question that this is not a case against the state. This is not a case in which Eleventh Amendment immunity can be invoked, at least at this early stage on a motion to dismiss. If it is shown after discovery that somehow the state treasury is involved, then I certainly would like to revisit this issue on a motion for summary judgment.

On the question of the governmental immunity act, defendants did not comply. They must comply. This is

indeed a case which involves fraud claims. There is nothing that I see that exempts this type of a suit from giving notice; and when state claims are brought against the governmental entity, it must be done in accordance with the – with the statute.

It appears that the legislature – yes, they wanted these security claims to exist, but it also passed the immunity statute and wanted notice to be given to the governmental entities. So Denver can be sued for violations of the state fraud statutes, but that suit must give notice pursuant to the state statute.

Therefore, the motion to dismiss will be granted as to the state claims only, which are dismissed for failure to comply with the Colorado governmental immunity act.

I will hope that the parties will have some [p. 28] conversation together to see if this case can be resolved. I urge very strongly that they work with the magistrate judge and see if this case can be resolved. I just wanted to mention that a lot of things have changed since this lawsuit was filed. And this is not a point of law but just a matter of personal information. I asked a broker about getting some double tax exempt bonds, and the ones which he suggested were insured Triple A DIA bonds; so apparently there has been some – if this information is correct, and it's absolutely hearsay – there have been some changed circumstances. And I would hope that since the airport is doing so well and that if the bonds are apparently doing so well that this case can be resolved in a good faith manner.

Anything further?

APPENDIX C

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO
Judge Zita L. Weinshienk

Civil Action No. 95-Z-468

BONNIE SONNENFELD, Individually and on behalf of all those similarly situated,

Plaintiff,

v.

THE CITY AND COUNTY OF DENVER, COLORADO,

Defendant.

and consolidated Civil Action No. 95-Z-492

KARL NICOLETTI, On Behalf of Himself, and All Others,

Plaintiff,

v.

THE CITY AND COUNTY OF DENVER COLORADO; et al.,

Defendants.

and consolidated Civil Action No. 95-Z-548

HILDA EBLING STOLLER TRUST, by Hilda Stoller, a/k/a Hilda Stoller Milstein, Trustee,

Plaintiff,

v.

THE CITY AND COUNTY OF DENVER, COLORADO,

Defendant.

and consolidated Civil Action No. 95-Z-728

LARRY RABINOWIFZ, On Behalf of Himself and All Others Similarly Situated,

Plaintiff,

v.

THE CITY AND COUNTY OF DENVER, COLORADO; et al.,

Defendants.

ORDER DISMISSING CERTAIN CLAIMS

(Filed Aug. 2, 1995)

This matter was before the Court on July 17, 1995, for oral argument on the Motion to Dismiss Claims Against the City And County Of Denver, Colorado. The Court heard the arguments and statements of counsel and made oral conclusions of law which are incorporated herein by reference as if fully set forth. Accordingly, it is

ORDERED that The Motion To Dismiss Claims Against The City And County Of Denver, Colorado is denied as to whether municipalities are exempt from Section 10(b) liability claims and as to Eleventh Amendment immunity claims, it is

FURTHER ORDERED that said motion is granted as to the claims relating to the Colorado Governmental Immunity Act, and plaintiff's state claims, which are contained in plaintiff's Second and Third claims for relief, are dismissed.

DATED at Denver, Colorado this 2 day of August, 1995.

BY THE COURT:

/s/ Zita L. Weinshienk,
ZITA L. WEINSHIENK, Judge
United States
District Court

APPENDIX D

S. Rep. No. 94-75, 94th Cong.,
1st Sess. 3, at 43-45
(1975 U.S.C.C.A.N. 179, 221-23)

6. *Nature of the Abuses in the Trading Markets for Municipal Securities*

The Committee believes the municipal securities markets have, in the main, performed their debt financing functions for state and local governments and other municipal agencies with commendable efficiency and integrity. However, there have been a number of cases of abuses in recent years which the Committee believes justify federal regulation of the municipal securities business for the protection of investors and the public interest.

Fraud actions against municipal securities professionals during the last four years reveal that unwary investors are often exposed to sharp and illegal practices. During that period the Commission brought seven injunctive actions, involving over 72 defendants, to halt fraudulent municipal securities trading practices. Perusal of the Commission's complaints in these actions (summarized in Commission Litigation Release Nos. 5583 and 5584 (October 26, 1972), 6005 (August 2, 1973), 6032 (August 22, 1973), 6451 (July 24, 1974), 6575 (November 6, 1974), and 6733 (February 13, 1975)) reveals a disturbing pattern of professional misconduct by a significant number of broker-dealers. This pattern is characterized by unconscionable markups, churning of customers' accounts, misrepresentations concerning the nature and value of municipal securities, disregard of suitability

standards, and scandalous high-pressure sales techniques. The selling practices of these firms involved all the characteristics of the classic "boiler room" operation. These practices are intended to induce hasty investment decisions with respect to securities unfamiliar to potential customers. Furthermore, it appears that certain firms exerted extraordinary pressures on their salesmen to increase sales without regard to the welfare of the firm's customers. In some instances bonds have been promoted as general obligations of the issuer whereas, in fact, they have been revenue bonds, sometimes in default.

Absent additional statutory authority, the reputable firms in the industry (which are an overwhelming majority) and the SEC appear to be unable to prevent these dangerous practices. Thus, the Committee has concluded the time has come to revise the Exchange Act to subject municipal securities professionals to essentially the same regulatory scheme that applies to other securities activities. It is of great importance to note that the Committee is joined in this decision by responsible and forward-looking members of the municipal securities industry and the Commission. The Committee has willingly accepted their cooperation and expertise in devising a suitable regulatory framework that will be responsive to the needs of the industry as well as to the protection of investors and the interests of governmental issuers in healthy and efficient markets for municipal securities.

B. REGULATION OF MUNICIPAL SECURITIES PROFESSIONALS – NOT ISSUERS

The Committee is mindful of the historical relationship between the federal securities laws and issuers of municipal securities. Apart from the general antifraud provision, municipal securities are exempt from all substantive requirements. Most significantly, this means that state and local governments do not have to comply with the registration and disclosure requirements of the Securities Act of 1933. The bill does not in any way change this pattern, for the Committee is not aware of any abuses which would justify such a radical incursion on states' prerogatives.

One of the Committee's primary concerns has been the impact of the envisioned regulatory pattern on municipal issuers. The Committee is convinced that regulation of the municipal securities industry will inevitably result in greater industry professionalism and greater investor confidence in the operations of the industry. Moreover, representatives of municipal issuers have recognized that failure to provide such regulation could result in the erosion of a system which has functioned very efficiently with remarkably few abuses. State and local governments have therefore recognized the desirability of regulation, which would maintain and enhance the strong markets which have developed, provided that there is no adverse impact on their capital raising activities.

Notwithstanding their general support for the objectives of the bill, municipal issuers have expressed concern about the possible collateral effects of the legislation.

Speaking on behalf of the Municipal Finance Officers Association, one witness at the hearings on S. 2474 (93d Cong., 2d Sess., 1974) stated:

> Proposed regulation of the municipal securities market, while clearly geared to the recently perceived needs to protect investors and to ensure the long-run confidence in our market, will bring about certain changes in that market and thus we are concerned about it. . . . We simply wish to identify those areas when we see possible collateral and 'splash' effects on the issuers growing out of the regulation of brokers, dealers, and dealer banks, and to ask for your consideration and clarification of such points about which we are uncertain . . .

While conceding that nothing in the legislation contemplates direct regulation of issuers or the registration of their securities, municipal issuers have nevertheless expressed concern over the possibility of indirect requirements being imposed through Commission or self-regulatory rules requiring dealers to secure certain types of information regarding the issuers of particular securities. Specifically, the fear has been expressed that requirements could be imposed which would have the effect of subjecting the information disclosed by issuers in connection with an offering to prior review or approval, thus resulting in a *de facto* registration requirement for municipal bonds.

As a practical matter, various forms of sale documents are utilized in connection with the marketing of municipal bond issues. These sale documents generally include an announcement of sale (which may be

in the form of an official advertisement or official offering circular or prospectus), an official bid form (utilized in non-negotiated offerings), and, in the case of revenue bonds, a draft of the indenture governing the indebtedness. The official advertisement and offering statement are designed to inform prospective purchasers of the precise terms upon which the bonds are being offered and various relevant matters concerning the issuer and the nature of the bonds.

The Committee agrees that no case has been made for the prefiling review, either directly or indirectly, of such sale documents, and has therefore included in the bill explicit language to prohibit the use of the rulemaking powers of the Municipal Securities Rulemaking Board and the Commission for this purpose. Sections 3(d) and 15B(d) of the Exchange Act (as amended by the bill.) Although the legislation would not permit any such prefiling requirements, all documents and materials utilized in connection with the sale would remain subject to the antifraud provisions of the Exchange Act. The bill assures that access of state and local governments to the capital markets will not be regulated in ways not now permitted under the fraud provisions of the federal securities laws.